

## ECONOMIC OUTLOOK

The following sections present a review the U.S. and Albuquerque MSA economies as of October 2004 when the Five-Year Forecast was prepared. In general the forecasts have not changed substantially, though employment growth for 2004 is above the forecast and oil prices are substantially above forecast levels. For the Albuquerque MSA employment growth for 2004 was anticipated to grow at 1.6%, but as

benchmarked by the Bureau of Labor Statistics, growth was 2.4%. Although employment growth is strong, Gross Receipts Tax (GRT) revenue has not been very strong. This follows a year where GRT revenue was strong while employment growth was weak. Although oil prices are at all time nominal highs reaching above \$60/bbl, the impact on the growth, of the national economy, has been relatively moderate.

### NATIONAL ECONOMY AND KEY POINTS FROM THE GLOBAL INSIGHT OUTLOOK

The national economy has been growing slowly following the recession in 2001. FY/04 marked the beginning of a turnaround spurred in part by federal tax cuts. The third quarter of calendar year 2003 showed a 7% increase in real GDP and increases in employment, including revisions to past month's losses. FY/04 had real GDP growth of 4.5%, but this is expected to slow to under 4% for FY/05 and around 3% for the remainder of the forecast. Growth is now strong enough that the Federal Reserve Board (FRB) is beginning to increase rates. Still inflation remains under control even with the large increases in oil prices. Global Insight (GI) expects oil prices to remain around \$35/bbl, well above previous forecasts [In the GI August 2005 forecast oil prices are now expected to average \$58/bbl in FY/06].

GI also presents risks to the forecast in the form of optimistic and pessimistic scenarios. The pessimistic scenario, assigned a probability of 20%, assumes that the economy will be hit by a form of stagflation. Growth declines to 1% in the middle of 2005. This is driven in part by increases in inflation fed by high oil prices and the weak dollar. Inflation rises to 3% helped by declines in productivity. The FRB reacts to inflation pushing up interest rates to 6%. Unemployment increases, hitting a high of 6.5% in 2007. The optimistic scenario, assigned a probability of 20%, has stronger growth driven by productivity increases, which helps both inflation and budget deficits. The optimistic scenario is only slightly better than the baseline, while the pessimistic scenario has a strong impact on the economy. These scenarios are

included in the revenue forecast in the Alternative Scenarios section.

#### Gross Domestic Product (GDP)

GDP was negative for the second and third quarters of calendar year 2001 and FY/02 only had growth of 0.8%. In FY/03 the economy rebounded slowly to post 2.5% growth. Growth increases to 4.5% in FY/04. Growth slows to under 4% in FY/05 and remains at about 3% for the remainder of the forecast.

#### Employment and Productivity

As the economy moved into recession, unemployment jumped from the historically low rates of around 4% experienced from FY/99 to FY/02. Unemployment averaged 5.9% in FY/03 and declined slightly to 5.7% in FY/04. Unemployment continues a slight decline in FY/05 to about 5.5% and remains at this level for the remainder of the forecast. Employment growth has made some increases recently, but was only near zero in FY/04. FY/05 and FY/06 should have growth around 1.5% slowing to 1% for the remainder of the forecast. FY/04 showed strong productivity growth of 5.3% in output per hour, but GI expects this to drop to the range of 2% to 2.5%; well below the last several years.

#### Inflation

As measured by the consumer price index for urban consumers, inflation was 3.4% in FY/01. With the weak economy, inflation declined to 1.8% in FY/02. FY/03 and FY/04 showed inflation averaging about 2%. In FY/05 inflation

is expected to be about 2.5%, driven largely by oil price increases, but declines below 1.5% in FY/06. This slowly increases to 2% by the end of the forecast. Inflation is held in check, as there is little wage pressure as employment grows slowly and productivity increases hold costs down.

### **Interest Rates**

The Federal Reserve Board (FRB) cut rates to 1% the lowest level since the 1960s. The FRB has increased rates twice in 2004 and rates are expected to continue increasing. Rates are expected to average 2% for FY/05 and continue to increase to 3% by end of 2005, yielding an average rate of 3% for FY/05. Rates continue

up and end the forecast at 4.5% in FY/09. Long term rates also grow, but somewhat slower than the short term rates. The rates are still quite low historically.

### **World Economy**

GI believes that the world economy will continue to grow though at a slow rate. The dollar will continue to weaken and the current trade account deficit continues to grow to \$700 billion in FY/05 and remains there for the remainder of the forecast. This remains a source of risk to the economy. Slower growth in the rest of the world would lower export growth and hurt the U.S. economy and increase the existing trade imbalance.

## U.S. ECONOMIC VARIABLES AND FORECAST (FISCAL YEAR) October 2004 Baseline Forecast

